

Internal Revenue Service
memorandum

CC:TL:Br3
BGately

date: FEB 17 1989

to: District Counsel, Denver SW:DEN

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: Computation of § 6661 Penalty
Review of Technical Advice

As you requested we have reviewed the above referenced document. We wish to call your attention to the following two points.

On page three of your memorandum, in the section headed "Underpayment Attributable to Substantial Understatement", you correctly state that the amount of the underpayment and the amount of the understatement will differ in most cases. Further, you correctly state that the penalty is applied to the underpayment attributable to the understatement. However, you also state that the penalty is applied to the lesser of the underpayment and the understatement. A similar remark is made with respect to examples three and four, found on pages five and six of your memorandum.

As a general matter, your "short-hand" formulation is correct, i.e. the underpayment attributable to the substantial understatement can never exceed the lesser of the underpayment and the understatement. However, there may be cases, with computational permutations yet undiscovered (especially where the § 6659 penalty is asserted as well), in which the penalty would be calculated on an amount less than either of the two figures, underpayment and understatement. This could also result if the theory that the Tax Court used in Todd v. Commissioner, 89 T.C. 912 (1987), aff'd ___ F.2d ___ (5th Cir. 1988) (rehearing pending), to define "attributable to", is carried over into this area. The caution here is that there may be instances where counsel would need to examine, item by item, the nexus between the understatement calculated and the underpayment calculated, to determine the attribution under § 6661. Nevertheless, these cases should be the rare ones, and given your audience and the intended function of your memorandum, we have no objection to your recommendation of the "short-hand" approach.

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We note with reference to your discussion of Woods, on page two (last paragraph), that the acquiescence has been published, and can be found in Bulletin No. 1988-43 (released 10-24-88).

Other than these minor points, we think your advice to the district is correct and thorough. Your examples are excellent and should be of great value to the district. If we can be of further assistance on this subject, please feel free to contact us again.

MARLENE GROSS

By: 

DANIEL J. WILES
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